

HAIG POINT UTILITY, INC.

DOCKET NO. 2005-34-W/S

BEFORE THE SOUTH CAROLINA PUBLIC SERVICE COMMISSION

Testimony Prepared: June 13, 2005

Hearing Date: July 18, 2005

PRE-FILED TESTIMONY OF GARY C. WHITE

THIS TESTIMONY IS FILED PURSUANT TO THE ORDER OF THE PUBLIC SERVICE COMMISSION DATED APRIL 11, 2005. IN ACCORDANCE WITH THE PUBLIC SERVICE COMMISSION'S RULES OF PRACTICE AND PROCEDURE AND THE AGREEMENT OF THE APPLICANT, THE COMMISSION, THE OFFICE OF REGULATORY STAFF, AND THE INTERVENOR, THE APPLICANT RESERVES THE RIGHT TO PROVIDE REBUTTAL TESTIMONY TO THE TESTIMONY PRE-FILED PURSUANT TO SAID ORDER BY THE COMMISSION STAFF, ORS, AND INTERVENORS AND TO ANY TESTIMONY PROVIDED AT OR BEFORE THE JULY 18, 2005 HEARING AND THE JULY 14, 2005 PUBLIC "NIGHT" HEARING.

1 **BY MR. WALKER: Please state your name for the record.**

2

3 BY MR. WHITE: Gary C. White.

4

5 **BY MR. WALKER: Please state your business address.**

6

7 BY MR. WHITE: 3 Sleepy Hollow Drive, Clifton Park, New York.

8

9 **BY MR. WALKER: What is your occupation?**

10

11 BY MR. WHITE: I am the Director of Accounting with Guastella Associates, Inc.

12

13 **BY MR. WALKER: Can you describe the business of Guastella Associates, Inc.?**

14

15 BY MR. WHITE: Guastella Associates, Inc. is a consulting firm established in 1978 by
16 John F. Guastella. The firm specializes in providing utility consulting services, including
17 rate and valuation services, to public and privately-owned water and sewer utilities.

18

19 **BY MR. WALKER: Where is Guastella Associates, Inc. located?**

20

21 BY MR. WHITE: Our central office is located in Boston with additional offices in
22 Florida and New York.

23

1 **BY MR. WALKER: Please state your educational background.**

2

3 BY MR. WHITE: I received a Bachelor of Science in Business Administration from
4 Valparaiso University in 1972, majoring in accounting, with a minor in finance.

5

6 **BY MR. WALKER: Have you completed additional training and/or education**
7 **since your graduation from Valparaiso University?**

8

9 BY MR. WHITE: I have completed a course in utility rate regulation sponsored by the
10 National Association of Regulatory Utility Commissioners ("NARUC"), the Florida
11 Public Service Commission, and the University of Utah.

12

13 **BY MR. WALKER: Please state your work history.**

14

15 BY MR. WHITE: I was employed in the unregulated, private industry sector between
16 1972 and 1984, with responsibilities in various areas of business management,
17 accounting and finance. Since 1984, my experience has been concentrated in the areas of
18 management, valuation, and rate setting for water and sewer utilities. During this period,
19 I was responsible for the rate regulation department of General Development Utilities,
20 Inc. which was the largest investor-owned water and sewer utility in Florida. I was
21 subsequently employed as General Manager of Country Knolls Water Works, Inc., an
22 investor-owned utility in upstate New York. I managed all of the utility's regulatory,

1 accounting and operations activities on a day-to-day basis. I began my employment with
2 Guastella Associates in 1992.

3
4 **BY MR. WALKER: Please state your particular expertise in the regulation of**
5 **utilities and other utility matters.**

6
7 BY MR. WHITE: My experience in utility matters includes the preparation of cost of
8 service and revenue requirement analyses for both private and municipal utilities. I have
9 prepared cost allocation, connection charge, and rate design studies; revenue requirement
10 forecasts; population growth and system capacity projections; market value analyses and
11 various operations and management evaluations. I have provided rate, regulatory and
12 system valuation services for clients in Alaska, Arizona, California, Connecticut, Florida,
13 Georgia, Illinois, Indiana, Maine, Maryland, Massachusetts, Montana, New Jersey, New
14 Mexico, New York, Ohio, Pennsylvania, Rhode Island, and South Carolina. I have
15 served as an instructor at several seminars for developer-related water and sewer utilities,
16 sponsored by Florida State University and the University of Florida, and at a utility rate
17 seminar conducted by the New England Chapter of the National Association of Water
18 Companies.

19
20 **BY MR. WALKER: How long have you practiced in the area of utility**
21 **management and rate regulation?**

22
23 BY MR. WHITE: I have been involved in the utility industry for over twenty years.

1 **BY MR. WALKER: Before what regulatory agencies and municipal jurisdictions**
2 **have you presented expert testimony?**

3
4 BY MR. WHITE: I have testified as an expert witness in regulatory hearings in
5 Connecticut, Florida, New Jersey, New York, and South Carolina.

6
7 **BY MR. WALKER: Please describe the nature of your assignment in connection**
8 **with this proceeding.**

9
10 BY MR. WHITE: Haig Point Utility Company, Inc. ("HPU") retained Guastella
11 Associates to provide expert review of the issues involved with this proceeding. My
12 assignment was to examine the financial information and operating data of the utility, and
13 to coordinate my work with that of John F. Guastella in the preparation of a rate analysis
14 in support of this filing.

15
16 **BY MR. WALKER: Did you meet with or receive data from individuals**
17 **representing HPU in connection with your assignment?**

18
19 BY MR. WHITE: Yes. Throughout the process of preparing the rate study, which
20 supports HPU's application for a rate increase, I have worked closely with HPU's
21 management to assure the application accurately depicts HPU's financial position and
22 contains the information necessary to establish its cost of providing its services. I have

1 also received data from HPU's engineering firm, Thomas & Hutton Engineering
2 Company.

3

4 **BY MR. WALKER: Who did you meet with or receive data from in connection**
5 **with your assignment?**

6

7 BY MR. WHITE: Thomas Connor, who provided financial data on behalf of HPU, and,
8 as well, provided me with data collected by Jim Collins, an engineer with Thomas &
9 Hutton's Savannah, Georgia office.

10

11 **BY MR. WALKER: What documents or data did you receive from Mr. Connor?**

12

13 BY MR. WHITE: Mr. Connor provided financial data on behalf of HPU, including
14 HPU's balance sheet and income statements, as well as data related to HPU's financial
15 position, historical operating costs, and projected future operating costs.

16

17 **BY MR. WALKER: Were you present when Mr. Connor testified earlier?**

18

19 BY MR. WHITE: Yes.

20

21 **BY MR. WALKER: In his testimony, Mr. Connor outlined a list of documents and**
22 **data he supplied to Guastella Associates in connection with the rate study. Was the**
23 **list supplied by Mr. Connor complete and accurate?**

1 BY MR. WHITE: Yes.

2

3 **BY MR. WALKER: Did you request these documents or data from Mr. Connor?**

4

5 BY MR. WHITE: Yes, the information provided was essential to performing my
6 analysis.

7

8 **BY MR. WALKER: Were the documents and data you received from Mr. Connor**
9 **of a type reasonably relied upon by experts within your field of expertise to form**
10 **opinions or complete a rate study?**

11

12 BY MR. WHITE: Yes.

13

14 **BY MR. WALKER: What documents or data did you receive from Mr. Collins?**

15

16 BY MR. WHITE: I received via Mr. Connor an Excel spreadsheet prepared by Mr.
17 Collins, which provided information on various construction projects within Haig Point
18 Plantation. For each project, Mr. Collins provided the approximate scope of water
19 distribution, the approximate scope of sewage collection, the date of operating permit
20 issuance, the value of the project, the value determination method, and various comments
21 regarding each project.

22

23 **BY MR. WALKER: Did you request these documents or data?**

1 BY MR. WHITE: Yes, the information provided was essential to performing my
2 analysis.

3

4 **BY MR. WALKER: Were the documents and data you received from Mr. Collins**
5 **via Mr. Connor of a type reasonably relied upon by experts within your field of**
6 **expertise to form opinions or complete a rate study?**

7

8 BY MR. WHITE: Yes.

9

10 **BY MR. WALKER: Did you receive any other documentation or data from anyone**
11 **else to assist in your rate study?**

12

13 BY MR. WHITE: Yes. I received via Mr. Connor data on water usage from Sabina
14 Finnegan, who I understand to be an engineer and an officer of HPU.

15

16 **BY MR. WALKER: Did you request these documents or data?**

17

18 BY MR. WHITE: Yes, the information provided was essential to performing my
19 analysis.

20

21 **BY MR. WALKER: Were the documents and data you received from Ms.**
22 **Finnegan via Mr. Connor of a type reasonably relied upon by experts within your**
23 **field of expertise to form opinions or complete a rate study?**

1 BY MR. WHITE: Yes.

2

3 **BY MR. WALKER: Did you rely upon other information in performing the**
4 **analyses contained in your rate study?**

5

6 BY MR. WHITE: Yes. I relied upon my accounting experience, upon my experience in
7 the utility industry, and upon certain statistics published by the National Association of
8 Water Companies' ("NAWC") Economic Research Program. This data was published in
9 1999 and is an analysis of various investor-owned water utilities. The data is broken
10 down into sub-groups according to revenues and according to geographic region.

11

12 **BY MR. WALKER: Is the data contained in the 1999 NAWC study contained**
13 **within the schedules or work papers Guastella Associates submitted in support of**
14 **the rate application?**

15

16 BY MR. WHITE: Yes. The data is summarized in Schedule A-4 to the rate application.

17

18 **BY MR. WALKER: Was information gleaned from this statistical data and your**
19 **practical experience in the utility industry of a type reasonably relied upon by**
20 **experts within your field of expertise to form opinions or complete a rate study?**

21

22 BY MR. WHITE: Yes.

23

1 **BY MR. WALKER: Was the other data obtained from Mr. Connor, Ms. Finnegan,**
2 **and Mr. Collins incorporated into the schedules or work papers Guastella**
3 **Associates submitted in support of the rate application?**

4
5 BY MR. WHITE: Yes. The data was utilized in drafting all of the schedules and work
6 papers submitted in support of the rate application.

7
8 *[APPLICANT'S EXHIBIT 4-RATE STUDY]*

9 **BY MR. WALKER: What was your purpose in performing the rate study?**

10
11 BY MR. WHITE: To examine HPU's financial data, including revenue, expenses, and
12 capital investments, in order to determine the revenue requirement, or the cost of
13 providing a service, in the projected future. This, in turn, allows us to structure a rate plan
14 which will meet the revenue requirement.

15
16 **BY MR. WALKER: Is there any particular methodology you used in completing**
17 **the rate study?**

18
19 BY MR. WHITE: Mr. Guastella and I used a "complete system" methodology in
20 completing the analysis.

21
22 **BY MR. WALKER: What is a "complete system" methodology?**

1 BY MR. WHITE: In this type of analysis the revenue requirement is based on the
2 projected cost of providing service and projected revenues when all potential customers
3 are connected to the utility system. The projections are based on current costs, not
4 adjusted for inflation.

5

6 **BY MR. WALKER: What is the benefit of using the “complete system”**
7 **methodology?**

8

9 BY MR. WHITE: This method of developing rates for a growing utility system results in
10 rates that are lower than would otherwise be calculated using the current cost of
11 providing services. The complete system analysis places the risk of success of the real
12 estate venture on the developers/owners, not on the utility customers. The utility
13 customer will pay only his proportionate share of the cost of providing service to the fully
14 developed utility system, with the developers/owners automatically absorbing the
15 unrecovered costs.

16

17 **BY MR. WALKER: What was the revenue requirement shown by the rate study?**

18

19 BY MR. WHITE: The study produced a total revenue requirement of \$455,743.00 for
20 the water system and \$535,929.00 for the sewer system.

21

1 **BY MR. WALKER: How much of an increase in existing water rates does this new**
2 **revenue requirement reflect?**

3

4 BY MR. WHITE: The revenue requirement, at system build-out, reflects a \$176,946.00
5 increase over existing water rates.

6

7 **BY MR. WALKER: How much of an increase in existing water revenues does this**
8 **new revenue requirement reflect?**

9

10 BY MR. WHITE: It equates to a 63.5% increase in water revenues.

11

12 **BY MR. WALKER: How much of an increase in existing sewer rates does this new**
13 **revenue requirement reflect?**

14

15 BY MR. WHITE: The revenue requirement, at system build-out, reflects a \$369,688.00
16 increase over existing water rates.

17

18 **BY MR. WALKER: How much of an increase in existing sewer revenues does this**
19 **new revenue requirement reflect?**

20

21 BY MR. WHITE: It equates to a 222.4% increase in sewer revenues.

22

1 **BY MR. WALKER: What rate of return did you utilize to reach the net operating**
2 **income?**

3

4 BY MR. WHITE: The net operating income is based on an overall rate of return of
5 9.25%.

6

7 **BY MR. WALKER: What test period or periods did you use?**

8

9 BY MR. WHITE: Our analyses are based on historical June 30, 2004 financial
10 information and a pro forma test year projected through the period of complete system
11 build-out, adjusted for known and measurable changes.

12

13 **BY MR. WALKER: Have you prepared schedules that summarize your rate**
14 **analysis?**

15

16 BY MR. WHITE: Yes, I will briefly describe all of the schedules submitted in support of
17 the rate increase. As well, Mr. Guastella's testimony may address some of the schedules
18 and certain issues within this rate application. These are contained in Applicant's Exhibit
19 4.

20

21 **BY MR. WALKER: Were all of the schedules we are about to discuss prepared by**
22 **you?**

23

1 BY MR. WHITE: Yes, using data provided to me by HPU and its engineering firm,
2 Thomas & Hutton as well as based upon my experience within the field.

3

4 **BY MR. WALKER: Please explain Schedule A-1**

5

6 BY MR. WHITE: Schedule A-1 shows HPU's consolidated water and sewer balance
7 sheet as of June 30, 2004. This schedule reflects the assets, liabilities and equity as
8 recorded and shows HPU's financial position as of June 30, 2004.

9 *[Contained within Applicant Exhibit 4]*

10

11 **BY MR. WALKER: Please explain Schedule A-2.**

12

13 BY MR. WHITE: This schedule contains the consolidated annual income statement for
14 the twelve month period ended June 30, 2004. The amounts shown on Schedule A-2
15 reflect the actual level of income generated by the water and sewer operations of the
16 Company.

17 *[Contained within Applicant Exhibit 4]*

18

19 **BY MR. WALKER: Please explain Schedule A-3.**

20

21 BY MR. WHITE: Schedule A-3 shows the Company's capital structure and rate of
22 return using a hypothetical 50% level of debt and equity. The schedule also utilizes the
23 South Carolina Public Service Commission's method of calculating the operating margin.

1 *[Contained within Applicant Exhibit 4]*

2

3 **BY MR. WALKER: Please explain why you utilized the hypothetical 50% level of**
4 **debt and equity.**

5 BY MR. WHITE: The current capital structure is all equity with no long-term debt
6 issued. HPU is proposing the use of a projected capital structure composed of 50% long-
7 term debt and 50% common equity. The use of this hypothetical capital structure results
8 in a lower revenue requirement than would be necessitated by one reflecting 100%
9 equity.

10

11 **BY MR. WALKER: What was the operating margin you calculated using the**
12 **method utilized by the South Carolina Public Service Commission?**

13

14 BY MR. WHITE: 14.3%.

15

16 **BY MR. WALKER: Please explain how Schedule A-4 relates to Schedule A-3.**

17

18 BY MR. WHITE: Schedule A-4 was included to demonstrate that the calculated
19 operating margin of 14.3% as reflected on Schedule A-3 is within a range of
20 reasonableness. The information provided shows that this operating margin is in line
21 with the range of both the revenue group of \$1-\$5 million utilities and the South Region
22 sub-group. HPU would be considered a part of the revenue group and the South Region
23 sub-group for comparison purposes.

1 *[Contained within Applicant Exhibit 4]*

2

3 **BY MR. WALKER: On what data or research did you rely in defining the**
4 **operating margins for the sub-groups compared to HPU in Schedule A-4?**

5

6 BY MR. WHITE: I utilized data collected by the National Association of Water
7 Companies ("NAWC"), a national trade association. The data was published in 1999 as
8 part of the NAWC's economic research program.

9

10 **BY MR. WALKER: Please explain Schedule B-1.**

11

12 BY MR. WHITE: Schedule B-1 sets forth the computation of the rate base for both the
13 water rate and sewer rate. This schedule shows the rate base components as of June 30,
14 2004, adjustments and pro forma complete system test year balances that are used to
15 develop HPU's revenue requirement.

16 *[Contained within Applicant Exhibit 4]*

17

18 **BY MR. WALKER: What are the components of the rate bases shown in Schedule**
19 **B-1?**

20

21 BY MR. WHITE: The components are the Plant in Service, Accumulated Depreciation,
22 Construction Work in Progress ("CWIP"), Contributions in Aid of Construction, and
23 Accumulated Amortization of Contributions in Aid of Construction. These totaled

1 together equal the Net Plant. To the Net Plant total, I added Working Capital and
2 Unamortized Balances to determine the rate base.

3

4 **BY MR. WALKER: Why do you utilize a 1/5th working capital calculation?**

5

6 BY MR. WHITE: The 1/5th working capital requirement is a version of the modified
7 Federal Power Commission formula. HPU bills quarterly in arrears on a ninety day
8 cycle. The formula reasons that, on average, service is provided an average of 45 days
9 prior to billing the customer for that service and that it will take an average of 30 days
10 before the customer's payment is received. This results in a 75 day lag period, or
11 approximately 1/5 of a year, and, therefore, the 1/5th working capital allowance is
12 provided based on annual operating and maintenance ("O&M") expense costs. This lag
13 represents a capital requirement placed on HPU and is a positive rate base adjustment.

14

15 **BY MR. WALKER: Please explain the average unamortized balance on Schedule**
16 **B-1.**

17

18 BY MR. WHITE: The average unamortized balance represents HPU's average balance
19 of unrecovered rate case expense. As such, this becomes a capital requirement of the
20 utility and is a positive rate base adjustment.

21

22

1 **BY MR. WALKER: Please explain Schedule B-2**

2

3 BY MR. WHITE: Schedule B-2 shows the detail of Plant in Service by plant category. It
4 begins with the original cost of plant in service as of June 30, 2004 and brings the
5 accounts forward through the pro forma complete system balances. The totals from this
6 schedule are brought forward to the rate base calculation on Schedule B-1.

7 *[Contained within Applicant Exhibit 4]*

8

9 **BY MR. WALKER: Please explain Schedule B-3.**

10

11 BY MR. WHITE: Schedule B-3 contains Accumulated Depreciation by plant category,
12 along with the detailed adjustments necessary to formulate the pro forma complete
13 system balances. The development of annual depreciation accruals for the period through
14 system build-out are supported and detailed on Work Papers 3 (water) and 4 (sewer).

15 *[Contained within Applicant Exhibit 4]*

16

17 **BY MR. WALKER: Please explain Schedule B-4.**

18

19 BY MR. WHITE: Contributions in Aid of Construction (CIAC) and the amortization of
20 the CIAC component of rate base are set forth on Schedule B-4. Work Paper 6 develops
21 the CIAC and the Amortization of CIAC levels through the period of system completion.
22 Again, the balances from Schedule B-3 and B-4 are brought forward to the rate base,
23 Schedule B-1.

1 *[Contained within Applicant Exhibit 4]*

2
3 **BY MR. WALKER: Please explain Schedules C-1(W) and C-1(S).**

4
5 BY MR. WHITE: These schedules are the pro forma operating statements or income
6 statements for water and sewer, respectively. Schedules C-1 shows HPU's operating
7 results for the historical twelve months ended June 30, 2004 under present and proposed
8 rates. Both schedules also show pro forma adjustments and operating results for the
9 complete system analysis under present and proposed rates. The schedules summarize
10 HPU's cost of operations, resultant net operating income and rate of return. The
11 numbered adjustments on Schedules C-1(W) and C-1(S) reference the explanations of
12 those adjustments provided on Schedules C-2(W) and C-2(S).

13 *[Contained within Applicant Exhibit 4]*

14
15 **BY MR. WALKER: Please summarize the results of Schedule C-1(W) for the pro**
16 **forma test year.**

17
18 BY MR. WHITE: Schedule C-1(W) shows the "Complete System" revenue requirement
19 of \$455,746.00 for water for the pro forma test year. Again, this pro forma test year is
20 projected through the period of complete system build-out, adjusted for known and
21 measurable changes. This revenue requirement covers the projected operating expenses
22 of \$355,486.00, providing net operating income of \$100,259.00. The result is an overall
23 9.25% rate of return on the "Complete System" rate base of \$1,083,852.00. The revenue

1 requirement is \$176,946.00 greater than the revenue of \$278,800.00 that would be
2 generated by the existing rates at system build-out, or an increase of 63.5%. The revenue
3 levels under present and proposed rates are supported in the billing analyses set forth on
4 the top half of Schedules E-2 and E-3, respectively.

5 ***[Contained within Applicant Exhibit 4]***

6

7 **BY MR. WALKER: Did you make adjustments to the operating statement for the**
8 **water system?**

9

10 BY MR. WHITE: Yes. These adjustments are listed on Schedule C-2(W).

11 ***[Contained within Applicant Exhibit 4]***

12

13 **BY MR. WALKER: Would you briefly describe the adjustments on C-2(W)?**

14

15 BY MR. WHITE: Yes. Adjustments (1a) through (1f) annualize revenue, by customer
16 class, for the full compliment of water customers for the complete system under present
17 rate and proposed rates.

18

19 Adjustment (1g) eliminates the service availability income because at system completion
20 all potential customers would be connected and no future growth would exist to generate
21 service availability revenues.

22

23 Adjustment (2) increases wages to reflect the projected cost for the complete system
24 water company employees.

1

2 Adjustment (3) reflects projected increases in repair and maintenance costs relative to the
3 level of water plant in service.

4

5 Adjustment (4) projects increases in operating supply costs in proportion to projected
6 increases in water system demands.

7

8 Adjustment (5) increases office equipment costs relates to the increase in the number of
9 water customers.

10

11 Adjustment (6) proposes a decrease of per book bad debt expense to reflect a reasonable
12 or normal expected level of 2% of billed water revenue.

13

14 Adjustment (7) increases the purchased power costs to reflect an historical cost level for
15 projected complete system water demands.

16

17 Adjustment (8) reflects the increase in the annual depreciation accrual associated with the
18 complete system level of water plant in service.

19

20 Adjustment (9) reflects the estimated water rate case expense, amortized over a four year
21 period.

22

1 Adjustment (10) increases revenue taxes to reflect pro forma revenue levels under present
2 rates.

3
4 Adjustment (11) estimates projected property taxes at 1% of the original cost of the water
5 plant investment.

6
7 Adjustment (12) reflects the payroll taxes applicable to the level of complete system
8 wages for the water operation.

9
10 Adjustment (13) calculates the state and federal income tax on pro forma taxable income
11 under present rates.

12
13 Adjustment (14) corrects bad debt expense to reflect the impacts of the increased revenue
14 produced under proposed water rates.

15 Adjustment (15) increases revenue taxes to reflect pro forma revenue levels under
16 proposed water rates.

17
18 Adjustment (16) calculates the state and federal income tax on pro forma taxable income
19 under proposed water rates.

20
21 **BY MR. WALKER: Please summarize the results of Schedule C-1(S) for the pro**
22 **forma test year.**

1 BY MR. WHITE: Schedule C-1(S) shows the "Complete System" sewer revenue
2 requirement of \$535,940.00 which covers projected operating expenses of \$398,020.00
3 and produces \$137,919.00 of net operating income, resulting in an overall 9.25% rate of
4 return on the "Complete System" rate base of \$1,490,912.00. This revenue requirement is
5 \$369,688.00 greater than the revenue that would be produced by the existing rates at
6 system build-out, and reflects a 222.4% increase over revenue generated by existing
7 rates. The revenue levels under present and proposed rates are supported in the billing
8 analyses set forth on the lower half of Schedules E-2 and E-3, respectively.

9 *[Contained within Applicant Exhibit 4]*

10
11 **BY MR. WALKER: Did you make adjustments to the operating statement for the**
12 **sewer system?**

13
14 BY MR. WHITE: Yes. These adjustments are listed on Schedule C-2(S).

15 *[Contained within Applicant Exhibit 4]*

16
17 **BY MR. WALKER: Would you briefly describe the adjustments on C-2(S)?**

18
19 BY MR. WHITE: Yes. Adjustment (1a) through (1d) annualizes revenue, by customer
20 class, for the full compliment of sewer customers for the complete system under present
21 rate and proposed rates.

1 Adjustment (1e) eliminates the service availability income because at system completion
2 all potential customers would be connected and no future growth would exist to generate
3 service availability revenues.

4

5 Adjustment (2) increases wages to reflect the projected cost of the complete system sewer
6 employees.

7

8 Adjustment (3) proposes a decrease of per book bad debt expense to reflect a reasonable
9 or normal expected level of 2% of annual revenue produced by existing sewer rates.

10

11 Adjustment (4) increases the purchased power costs to reflect an historical cost level for
12 projected complete system sewer flows.

13

14 Adjustment (5) reflects the increase in the annual depreciation accrual associated with the
15 complete system level of sewer plant in service.

16

17 Adjustment (6) reflects the estimated sewer rate case expense, amortized over a four year
18 period.

19

20 Adjustment (7) increases revenue taxes to reflect pro forma revenue levels under present
21 sewer rates.

22

1 Adjustment (8) sets projected property taxes at 1% of the original cost of the sewer plant
2 investment.

3
4 Adjustment (9) reflects the payroll taxes applicable to the level of complete system wages
5 for the sewer operation.

6
7 Adjustment (10) calculates the state and federal income tax on pro forma taxable income
8 under present sewer rates.

9
10 Adjustment (11) shows the impacts of the increased revenue, under proposed sewer rates,
11 on the bad debt expense component.

12 Adjustment (12) increases revenue taxes to reflect pro forma revenue levels under the
13 proposed sewer rates.

14
15 Adjustment (13) calculates the state and federal income tax on pro forma taxable income
16 under the proposed rates.

17
18 **BY MR. WALKER: Please explain Schedule D-1.**

19
20 BY MR. WHITE: This schedule shows the capital structure and resulting cost of capital
21 or rate of return requested in this filing. Since HPU has no outside debt, a 50:50
22 hypothetical capital structure was used. A 7.5% debt cost rate and 11.0% equity rate of
23 return were applied to the capital components which were synchronized to HPU's rate

1 base investment. This methodology produced a weighted cost of capital of 9.25%,
2 which appears reasonable when tested using the South Carolina Public Service
3 Commission's method of calculating an operating margin, as demonstrated on Schedule
4 D-1.

5 *[Contained within Applicant Exhibit 4]*

6
7 **BY MR. WALKER: Please explain the billing analyses presented on Schedules E-1**
8 **and E-1.1.**

9
10 BY MR. WHITE: Schedule E-1 sets forth the water and sewer billing analyses for the
11 historical twelve-month period ended June 30, 2004. Schedule E-1.1 applies the
12 proposed rates to the same billing data as that presented on Schedule E-1, thereby
13 calculating the water and sewer revenues at year-end June 30, 2004 under proposed rates.
14 Schedule E-1.1 is provided to demonstrate, as can be seen on Schedule C-1(W) and C-
15 1(S) that applying the proposed rates to historical test year operations only produces a
16 1.71% rate of return for water and a 4.38% rate of return for sewer. The complete system
17 analysis results in rates that will produce the pro forma rate of return only when all
18 customers are connected. During the interim growth years, a revenue shortfall is
19 expected, as shown on the operating statement schedules, and will automatically be
20 absorbed by the stockholders.

21
22 *[Contained within Applicant Exhibit 4]*

1 **BY MR. WALKER: Please explain the billing analyses presented on Schedule E-2.**

2

3 BY MR. WHITE: Schedule E-2 sets forth the pro forma water and sewer billing analyses
4 under present rates when the system is complete with its full compliment of connected
5 customers.

6 *[Contained within Applicant Exhibit 4]*

7

8 **BY MR. WALKER: Please explain the billing analyses presented on Schedule E-3.**

9

10 BY MR. WHITE: Schedule E-3 applies the proposed rates to the same billing data as
11 appears on Schedule E-2, thus producing revenue equal to the complete system revenue
12 requirement. The billing analyses provide the detailed billing data for the revenues
13 presented on Schedule C-1(W) and Schedule C-1(S).

14 *[Contained within Applicant Exhibit 4]*

15

16 **BY MR. WALKER: Please explain Schedule E-4.**

17

18 BY MR. WHITE: Schedule E-4 shows a range of typical water and sewer quarterly bills
19 and compares the bills under present and proposed rates for various levels of metered
20 water usage. It should be noted that the existing water and sewer rates contain a
21 minimum usage allowance. This minimum allowance has been eliminated under the
22 proposed rates in an effort to promote conservation, and to establish a more generally
23 accepted rate structure.

1 *[Contained within Applicant Exhibit 4]*

2

3 **BY MR. WALKER: Briefly explain each of the work papers provided in support of**
4 **the rate filing schedules, all of which are contained within Applicant's Exhibit**
5 **Number 4.**

6

7 BY MR. WHITE:

8

9 Work Paper 1 contains the water and sewer revenue requirement calculations. It shows
10 the revenue requirement components under the complete system analysis.

11

12 Work Paper 2 reflects a detailed schedule of the water and sewer plant in service costs by
13 primary plant categories.

14

15 Work Paper 3 and 4 provide the detail of annual depreciation and accumulated
16 depreciation of the water and sewer plant in service, respectively.

17

18 Work Paper 5 shows annual customer growth to date and projected through system
19 completion.

20

21 Work Paper 6 calculates the proper level of Contributions in Aid of Construction (CIAC)
22 by applying the water and sewer connection fees to the annual connections made to each
23 system.

1 Work Paper 7 contains the water and sewer rate design schedules. For the purpose of
2 promoting water conservation, the water rate design holds the base service charge at its
3 existing levels, and flows the revenue increase through the usage charge component of
4 the rates. Since sewer revenues are much less usage sensitive, the ratio of base service
5 revenues to usage revenues was maintained in developing the proposed sewer rates.

6 Work Paper 8 reflects the quarterly billing data for the twelve months ended June 30,
7 2004.

8

9 Work Paper 9 sets forth the annual summary of the billing information presented on
10 Work Paper 8.

11

12 Work Paper 10 contains the pro forma billing data under the present rates.

13

14 Work Paper 11 contains the customer projections showing total connected units and total
15 demand for the complete system.

16

17 Work Paper 12 sets forth a consolidated factor bill analysis of the water system irrigation
18 customers. This work paper was used to create irrigation rates with an inclining block
19 rate designed to promote conservation and reduce irrigation usage.

20

21 Work Paper 13 reflects the "Statement of Proposed Rates" which shows the present and
22 proposed tariff rates and charges.

23

1 **BY MR. WALKER: Is the revenue requirement you calculated for both water and**
2 **sewer, in your expert opinion, warranted and reasonable?**

3

4 BY MR. WHITE: Yes.

5

6 **BY MR. WALKER: On what do you base your opinion that the proposed revenue**
7 **requirement is warranted and reasonable?**

8

9 BY MR. WHITE: I base my opinion upon a review of the financial data supplied to me
10 as reflected in the Schedules and Work Papers submitted in support of the rate
11 application, upon review of similarly situated utilities, and upon my professional
12 experience.

13

14 **BY MR. WALKER: Does this conclude your testimony/?**

15

16 BY MR. WHITE: Yes.